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August 18, 2003

VIA ECFS

Marlene H. Dortch, Secretary
Office of the Secretary
Federal Communications Commission
445 12th Street, S.W.
TW-A325
Washington, D.C. 20554

Re: *Verizon Petition for Forbearance from the Current Pricing Rules for the Unbundled Network Element Platform,* WC Docket No. 03-157

Dear Ms. Dortch:

Enclosed for filing in the above-referenced proceeding pursuant to the Commission's July 3, 2003 Public Notice Requesting Comments are the Comments of Focal Communications Corporation, McLeodUSA Telecommunications Services, Inc., PacWest Telecomm. Inc., and TDS Metrocom, L.L.C.

Should you have any questions concerning this filing, please do not hesitate to call me.

Respectfully submitted,

Harisha J. Bastiampillai

Enclosure

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Petition for Forbearance From The Current Pricing Rules for The Unbundled Network Element Platform	))))	WC Docket No. 03-157

COMMENTS OF
FOCAL COMMUNICATIONS CORPORATION,
McLEODUSA TELECOMMUNICATIONS SERVICES, INC.
PACWEST TELECOMM., INC., AND
TDS METROCOM, LLC.

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August 18, 2003

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SUMMARY

The Federal Communications Commission ('Commission") is poised to embark on a major rulemaking where it will revisit, reevaluate, and perhaps modify its TELRIC pricing rules. Verizon, however, via an Petition for Expedited Forbearance, states that the Commission must forbear from applying its TELRIC pricing rules to the UNE-Platform. As a threshold matter, there are procedural reasons why the Commission should deny this Petition. First, Section 160(d) of the Act precludes the Commission from forbearing from the requirements of Section 251(c) and Section 271 of the Act. The Commission has determined that its TELRIC pricing rules are necessary to implement the requirements of Sections 251(c) and 271. The Commission's rules implementing these sections, therefore, have the same status as the requirements of the sections themselves, particularly given the fact the Commission's implementation of the pricing requirements has been validated. Thus, although there is no basis for changing these pricing rules, the Commission would first have to implement new pricing rules before forbearing from TELRIC.

This leads to the second obstacle Verizon's Petition faces which is the fact that the Commission will be addressing many of the issues Verizon raises in its pending rulemaking proceeding. That proceeding is the forum in which these issues need to be addressed. Verizon raises challenges to TELRIC that implicate facilities beyond the UNE Platform, and any ruling by the Commission on these issues may unduly prejudge those issues on an incomplete record.

On a substantive basis, Verizon simply fails to prove its case. Verizon contends that TELRIC is not required by the Act, that it prevents ILECs from recovering their actual costs, and that it discourages investment. These arguments are merely tired recitations of arguments already long since repudiated by this Commission, the U.S. Supreme Court and marketplace

experience. The U.S. Supreme Court in the *Verizon* case found that TELRIC was not only a permissible ratemaking approach, but an appropriate one to implement the requirements of the Telecommunications Act of 1996. The Court noted that the Act sought to uproot the monopolies of the regional Bell Operating Companies ("RBOC") and determined that a departure from traditional rate-of-return ratemaking was needed to do this. TELRIC, with its focus on forward-looking efficient costs, mirrored the decision making of a merchant in the marketplace who must price the goods based not on his historical costs, but the current wholesale cost. This pricing sends the correct signals to competitors as to whether to build their own facilities or lease the ILEC's facilities. If it is more efficient to build; they will build. If it is more efficient to lease; they will lease.

Verizon also attempts to impugn the TELRIC pricing rules by characterizing them as based on "hypothetical" costs as opposed to actual costs. In reality, "hypothetical" is a misnomer when it comes to TELRIC. The Commission bases its forward-looking methodology on the existing wire center placements and the most efficient technology that is currently available. Thus, pricing has not been based on fantasy networks, but on current networks and current technology. The key element has been the focus on forward-looking costs, as opposed to the ILECs' actual costs, which everybody but the ILECs agree are grossly inflated in any event.

Perhaps the most fanciful of Verizon's challenges against TELRIC has been its contention that it discourages investment. The period from 1996 to 2001 saw unprecedented investment in telecommunications, with substantial facilities-based investment coming from both the incumbents and competitors. The last two years have seen reductions in capital spending, but this is an economy-wide phenomenon, and Verizon has shown no causative link to TELRIC pricing. There is also no need to modify TELRIC to promote RBOC investment, particularly in the broadband area. The RBOCs will presumably be garnering significant regulatory relief in the Triennial Review proceeding, and Verizon has not demonstrated that more relief is necessary.

If there is one principle to be gleaned from the seven years of commercial experience and litigation since the Commission implemented TELRIC it is the principle the Court espoused last year in validating TELRIC. The principle is that a forward-looking methodology, such as TELRIC, is extremely vital in regard to hard-to-duplicate facilities such as loop and transport facilities. It is too costly and too inefficient to expect CLECs to duplicate the ubiquitous RBOC network. Thus, TELRIC rules send correct pricing signals to competitors as to when to build new facilities. It is vital then that hard-to-duplicate facilities such as loops and transport continue to be subject to TELRIC pricing rules.

The Commission should also reject Verizon's challenge to CLECs collecting access charges when they lease the UNE Platform. It is beyond dispute that CLECs are service providers entitled to access charges when they lease UNEs, and the Commission has explicitly allowed this practice. Moreover, TELRIC compensates RBOCs for the forward-looking cost of their facilities. Thus, allowing them to receive access charges on top of this would provide a windfall.

Verizon also fails to meet the statutory test for forbearance. First, the current pricing rules are vital to ensuring nondiscriminatory charges, practices and classifications. The TELRIC rules have played a vital role in developing competition, and are crucial to protecting the competition that has developed. The existing pricing rules are necessary to protect the public interest.

Finally, Verizon has failed to demonstrate a need for expedited relief. While they cry financial distress to the Commission, their earnings statements paint a much more rosy picture.

Even assuming *arguendo*, that there has been a downturn for Verizon that is something more than what all companies have experienced, Verizon has not shown it is causally related to TELRIC. The financial analyst statements that Verizon points to understate its revenues and overstate it costs from their wholesale products. State commissions, who hold universal service as a paramount concern, have been extremely careful to ensure the RBOCs are well compensated and that their financial viability is not imperiled. Merely because Verizon is unsatisfied with the results of the state UNE proceedings is no reason to overturn the considered ratesetting that state commissions have conducted.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Petition for Forbearance From	)	
The Current Pricing Rules for	)	WC Docket No. 03-157
The Unbundled Network Element	)	
Platform	)	

COMMENTS OF
FOCAL COMMUNICATIONS CORPORATION,
McLEODUSA TELECOMMUNICATIONS SERVICES, INC.
PACWEST TELECOMM., INC., AND
TDS METROCOM, LLC,

Focal Communications Corporation ("Focal"), McLeodUSA Telecommunications Services, Inc. ("McLeodUSA"), PacWest Telecomm, Inc. ("PacWest"), and TDS Metrocom, LLC ("TDS Metrocom") submit these comments in response to the July 3, 2003 Public Notice seeking comment on the Petition for Forbearance filed by the Verizon Telephone Companies.[1] In its Petition, Verizon seeks expedited forbearance, pursuant to section 10 of the Telecommunications Act of 1996, 47 U.S.C. § 160, requesting the Commission to "immediately forbear from its decision permitting UNE-P carriers to collect per-minute access charges from long distance carriers . . . and . . . [to] forbear from applying its current TELRIC pricing rules to the . . . UNE platform."[2]

For the reasons stated below, the Commission should deny Verizon's Petition.

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[1] WC Docket No. 03-157, Pleading Cycle Established For Verizon Petition For Expedited Forbearance From The Commission's Current Pricing Rules For The Unbundled Network Element Platform, DA 03-2189 (July 3, 2003).

[2] Petition for Expedited Forbearance of the Verizon Telephone Companies at 1 (filed July 1, 2003).

I. THE COMMISSION MAY NOT RATIONALLY FORBEAR PENDING THE TELRIC RULEMAKING

A. A Grant of the Petition Would Unlawfully Assume The Validity of Verizon's Views of TELRIC

Verizon contends in its Petition that it needs expedited forbearance from this Commission's TELRIC pricing rules for the UNE Platform. While Verizon's Petition focuses on UNE-P many of the challenges it raises are to the TELRIC rules in general. Verizon contends that the rules discourage investment by carriers, impede competition, and impede economic growth. Among the specific challenges it raises is that TELRIC is too hypothetical, that it results in artificially low rates, and that it has led to a downturn in investment.

If the arguments raised by Verizon in its Petition sound familiar to this Commission, they should. Many of the arguments that Verizon raises constitute basically a recapitulation of arguments that Verizon, and the other RBOCs, have raised since this Commission implemented TELRIC in 1996. What is worse is the fact that many of these arguments were explicitly rejected by the U.S. Supreme Court just a year ago. Moreover, Verizon's statistics are incomplete at best, and misleading. Finally, even assuming *arguendo* Verizon's assertions, its arguments boil down to a laundry list of purported maladies it has experienced with no causal link to TELRIC demonstrated. As a review of its arguments demonstrate, Verizon has simply failed to provide the Commission with a basis to attach validity to any of its claims.

Most importantly, Verizon has not established any basis for the Commission to grant the expedited relief it seeks. The Commission is poised to embark on a comprehensive rulemaking concerning TELRIC and undoubtedly many, if not all, of these issues will be addressed in that proceeding. There is no need for the Commission to act on these issues now, and, if it does, it will unduly prejudge issues in that proceeding on a very incomplete record.

B. TELRIC Is Central To the Goals of the Telecommunications Act of 1996

1. The Commission Determined that TELRIC Is the Method to Implement the Requirements of the Act, Therefore the Commission May Not Forbear from its TELRIC Pricing Rules

Verizon asks the Commission to forbear based on its contention that TELRIC is not required by the Act.[3] In fact, this determination is critical because the Commission is statutorily proscribed from forbearing from the requirements of section 251(c) or 271.[4] Both sections pose obstacles to Verizon's petition. The Commission has determined that its TELRIC pricing rules make manifest the requirements of Sections 251(c) and 271. Thus, the FCC cannot forbear from its TELRIC pricing rules until it determines that these rules no longer are necessary under Sections 251(c) and 271 and that different rules are needed to implement the requirements of these Sections.

Section 251(c)(3) imposes a duty upon ILECs to provide UNEs based on rates that are just, reasonable and nondiscriminatory in accordance with the requirements of Sections 251 and 252.[5] The Commission held in the *Local Competition Order* that:

> we conclude here that prices for interconnection and unbundled elements pursuant to sections 251(c)(2), 251(c)(3), and 252(d)(1), should be set at forward-looking long-run economic cost. In practice, this will mean that prices are based on the TSLRIC of the network element, which we will call Total Element Long Run Incremental Cost (TELRIC), and will include a reasonable allocation of forward-looking joint and common costs.[6]

Likewise, Checklist Item 2 of Section 271 states that a Bell Operating Company ("BOC") must provide "nondiscriminatory access to network elements in accordance with the requirements of

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3 Verizon Petition at 19.

4 47 U.S.C. § 160(d).

5 47 U.S.C. § 251(c)(3).

6 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report & Order, 11 FCC Rcd 15499, ¶ 672 (1996) ("*Local Competition Order*"), *aff'd in part and vacated in part sub nom., Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8 th Cir. 1997) and *Iowa*

sections 251(c)(3) and 252(d)(1) of the Act."[7] Section 251(c)(3) requires LECs to provide "nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory . . . ."[8] Section 252(d)(1) mandates that state commissions should determine just and reasonable rates for network elements that are nondiscriminatory and based upon the cost of providing the network element.[9]

The Commission has determined that prices for unbundled network elements (UNEs) must be based on the total element long run incremental cost ("TELRIC") of providing those elements.[10] If the Commission is going to forbear from application of TELRIC, without making a determination that the requirements of Section 251 and 271 have been fully met, it must first establish that some other cost methodology meets the mandates of Section 251(c) and 271. Until it does, the Commission cannot forbear from the cost methodology it has chosen to give effect to those provisions.

2. The Commission Should Not Forbear from TELRIC

As a practical matter, also, the Commission should not forbear from application of TELRIC. This Commission has found that TELRIC is the methodology that furthers the goals of the 1996 Act. The Commission noted:

Utils. Bd. v. FCC, 120 F.3d 753 (8 th Cir. 1997), *aff'd in part and remanded, AT&T v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999).

[7] 47 U.S.C. § 271(B)(ii). Contrary to Verizon's assertions, the Commission has not stated that the requirements of Section 271 have been fully implemented.

[8] 47 U.S.C. § 251(c)(3).

[9] 47 U.S.C. § 252(d)(1). The State Commissions may factor in a reasonable profit when basing rates upon costs.

[10] *Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks, Inc. for Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 01-9, Memorandum Opinion and Order, FCC 01-130, ¶ 16 (Apr. 16, 2001) ("*Verizon MA 271 Order*").

> The 1996 Act encourages competition by removing barriers to entry and providing an opportunity for potential new entrants to purchase unbundled incumbent LEC network elements to compete efficiently to provide local exchange services. We believe that the prices that potential entrants pay for these elements should reflect forward-looking economic costs in order to encourage efficient levels of investment and entry.[11]

This conclusion was supported by state commissions throughout the U.S. Both incumbents and competitors have operated under this framework. If the Commission is going to alter this methodology, it must first conduct a proceeding that will establish a sufficient record to support such a departure. An unsubstantiated Petition for Forbearance is not the vehicle for this change.

3. The Supreme Court found TELRIC Well-Suited to Implement the Pricing Requirements of the Act

After nearly six years of appeals, the FCC's TELRIC pricing rules were affirmed by the U.S. Supreme Court in *Verizon*.[12] The Court found that FCC could require state commissions to set rates for leasing of unbundled network elements on a forward-looking basis that was untied to historical or past investment and that the methodology chosen by the FCC was not inconsistent with the plain language of the Act.[13] Perhaps even more important than the ultimate vindication the Court gave this Commission's rules was the strong language throughout the opinion that supported the FCC's TELRIC methodology. In its ruling, the Court considered, and explicitly rejected, many of the arguments that Verizon raises in its Petition.

The Court first observed the sea change that the Telecommunications Act of 1996 effected on historical approaches to ratemaking. The Court noted that under the local competition provisions of the Act, Congress called for ratemaking different from any historical practice, to achieve the entirely new objective of uprooting the monopolies that traditional rate-

11 *Local Competition Order* at ¶ 672.

12 *Verizon Communications, Inc., et al., v. Federal Communications Commission, et al.*, 122 S.Ct. 1646 (2002).

13 *Id.*

base methods had perpetuated."[14] This is reflected the admonition in Section 252 that a "rate-of-return or other rate based" methodology *not be used* to determine prices.[15] Rate-of-return proceedings are based upon use of historical costs.[16]

The Court noted that the Act was designed to promote "competition in the persistently monopolistic local markets, which were thought to be the root of natural monopoly in the telecommunications industry," and sought to "eliminate the monopolies enjoyed by the inheritors of AT & T's local franchises."[17] The Court noted that:

> For the first time, Congress passed a ratesetting statute with the aim not just to balance interests between sellers and buyers, but to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets.[18]

The Court noted that from the "constancy of dissatisfaction' with prior rate-making approaches:

> one possible lesson was drawn by Congress in the 1996 Act, which was that regulation using the traditional rate-based methodologies gave monopolies too great an advantage and that the answer lay in moving away from the assumption common to all the rate-based methods, that the monopolistic structure within the discrete markets would endure.[19]

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14 *Id.* at 1660.

15 47 U.S.C. § 252(d)(1)(A)(i) (emphasis added).

16 *See Illinois Bell Telephone Company v. FCC*, 988 F.2d 1254, 1258-59 (D.C.Cir. 1993)("*Illinois Bell*").

17 *Verizon*, at 1654. The Court cited to one of the main proponents of the Act who noted that:

> 'This is extraordinary in the sense of telling private industry that this is what they have to do in order to let the competitors come in and try to beat your economic brains out ....It is kind of almost a jump-start .... I will do everything I have to let you into my business, because we used to be a bottleneck; we used to be a monopoly; we used to control everything. "Now, this legislation says you will not control much of anything. You will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of the Bell operating companies network that is at least equal in type, quality, and price to the access [a] Bell operating company affords to itself.' 141 Cong. Rec. 15572 (1995). (Remarks of Sen. Breaux (La.) on Pub.L. 104-104 (1995)).

Id. at 1661.

18 *Id.* at 1661.

19 *Id.* at 1660.

In fact, the fault with past historical cost rate making approaches was that they were often "no match for the capacity of utilities having all the relevant information to manipulate the rate base and renegotiate the rate of return every time a rate was set."[20] While the RBOCs were migrated to price cap regulation, this did not eliminate the gamesmanship as "there are still battles to be fought over the productivity offset and allowable exogenous costs."[21]

The Court observed that the 1996 Act appears to be an "explicit disavowal of the familiar public-utility model of rate regulation (whether in its fair-value or cost-of-service incarnations) presumably still being applied by many States for retail sales . . . ***in favor of novel ratesetting designed to give aspiring competitors every possible incentive to enter local retail telephone markets***, short of confiscating the incumbents' property."[22] Such a ratemaking approach was necessary given the tremendous advantages that the RBOCs possessed.[23]

TELRIC, since it treated cost as a "forward-looking economic cost," met the requirements of the Act because it was distinct from "historically based cost" which had

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20 *Verizon*, 122 S.Ct. at 1660.

21 *Id.* at 1660.

22 *Id.* at 1661. (emphasis added)

23 The Court chronicled how control over the local exchange gives ILECs a nearly insurmountable advantage:

> A local exchange is thus a transportation network for communications signals, radiating like a root system from a "central office" (or several offices for larger areas) to individual telephones, faxes, and the like. It is easy to see why a company that owns a local exchange (what the Act calls an "incumbent local exchange carrier," 47 U.S.C. § 251(h)), would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well. A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses. The incumbent company could also control its local-loop plant so as to connect only with terminals it manufactured or selected, and could place conditions or fees (called "access charges") on long-distance carriers seeking to connect with its network. In an unregulated world, another telecommunications carrier would be forced to comply with these conditions, or it could never reach the customers of a local exchange.

Verizon, 122 S.Ct. at 1662.

generally been relied upon in valuing a rate base.[24] The Court in rejecting the RBOCs' argument that the Act's definition of cost must be based on their historical, actual costs astutely noted that "a merchant who is asked about the 'cost of providing the goods' he sells may reasonably quote the current wholesale market price, not the cost of the particular items he happens to have on his shelves."[25] The Court observed that ratemakers often rejected the utilities "embedded costs" (their own book value estimates) "which typically were geared to maximize the rate bases with high statements of past expenditures and working capital, combined with unduly low rates of depreciation."[26] Thus, the Court concluded it would be "passing strange to think Congress tied 'cost' to historical cost without a more specific indication. . . . "[27]

C. The Commission Should Reject Overtures to Focus on Actual Costs

Verizon contends that the Commission's TELRIC rules are grounded not in the incumbent's existing network, but in a hypothetical network.[28] The U.S. Supreme Court, however, found the Commission's use of a forward-looking network approach not only permissible but appropriate given the inefficiencies and inflated costs rooted in RBOC networks. A focus on the RBOCs' "actual" costs would undermine the goals of the 1996 Act. Verizon needs to demonstrate why the Commission should abandon a forward-looking, economically efficient network approach that has stood the test of time and litigation, and has succeeded in promoting and protecting competition, in favor of an actual cost approach that would revisit the ills of historical cost ratemaking repudiated by Congress and this Commission. Verizon faces a high burden in asking the Commission to return to historical cost based ratemaking.

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24 *Id.* at 1664.
25 *Id.* at 1666.
26 *Id.* at 1666.
27 *Id.* at 1667.
28 Verizon Petition at 2.

Verizon contends that TELRIC results in UNE rates that are well below what the ILEC can match.[29] The absurdity of this contention is evidenced in the fact that ILECs still control over 87% of the access lines in the U.S.[30] If the RBOCs could not match competitive prices, one would expect that percentage to be much smaller. RBOCs can and do match prices every day as demonstrated by the aggressive winback policies they engage in. Moreover, for the fourth quarter 2002 Verizon reported revenue growth and strong sales in regard to its bundled service offerings which would include its local and long distance service.[31] These are not the indications of a carrier that is unable to match competitive prices. Moreover, if UNE rates were so lucrative it is not clear why the market has not witnessed the promised RBOC out-of-region market entry. Surely the RBOCs would not want to pass up such an opportunity to reap these "high profits" especially if they are in such purported distress.

The Court explicitly considered, and rejected, the RBOC's challenge of the TELRIC's use of "hypothetical" costs. The Court observed that what the "incumbents call the 'hypothetical' element is simply the elements valued in terms of a piece of equipment an incumbent may not own."[32] In fact, the Court noted that the FCC "***would have had some more explaining to do if it had not changed its course by favoring TELRIC over forward-looking methodologies tethered to actual costs***, given Congress's clear intent to depart from past ratesetting statutes in passing the 1996 Act."[33] Thus, the Court is explicitly suggesting that an approach such as TELRIC was not only an appropriate choice by the Commission, but perhaps a

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29 Verizon Petition at 2.

30 *Federal Communications Commission Releases Data on Local Telephone Competition*, FCC Press Release (June 12, 2003).

31 *Verizon Communications Reports Strong Yearly Operational Growth and Gives Outlook for 2003*, Verizon Press Release (Jan. 29, 2003).

32 *Verizon,* 122 S.Ct. at 1667.

33 *Id.* at 1668, n. 20. (emphasis added).

necessary one. The Court also suggests that the Act explicitly calls for a departure from a focus on the "actual" costs of the RBOCs.

One must emphasize the term "hypothetical" is really a misnomer in the TELRIC methodology. The Commission did not choose a hypothetical network approach. Instead they based the pricing rules on the ILECs' existing network design and the most efficient technology "currently available." As the Commission noted:

> Under the third approach, prices for interconnection and access to unbundled elements would be developed from a forward-looking economic cost methodology based on the most efficient technology deployed in the incumbent LEC's current wire center locations. This approach mitigates incumbent LECs' concerns that a forward-looking pricing methodology ignores existing network design, while basing prices on efficient, new technology that is compatible with the existing infrastructure. This benchmark of forward-looking cost and existing network design ***most closely represents the incremental costs that incumbents actually expect to incur in making network elements available to new entrants***. Moreover, this approach encourages facilities-based competition to the extent that new entrants, by designing more efficient network configurations, are able to provide the service at a lower cost than the incumbent LEC. We, therefore, conclude that the forward-looking pricing methodology for interconnection and unbundled network elements should be based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements.[34]

As the Court noted, "TELRIC does not assume a perfectly efficient wholesale market or one that is likely to resemble perfection in any foreseeable time."[35] The application of TELRIC by state commissions has adhered closely to the ground rules laid out by the Commission. States have based rates on placement of existing wire centers and have assumed technology that is only currently available. Moreover, while current technology may supply more efficiency than the ILECs assume in their cost models, states have been reluctant to apply this greater efficiency. For instance, modern OSS can support flow-through rates of 98% and above, but states often rely

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34 *Local Competition Order,* ¶ 685.

on the actual flow through rates of the ILEC. For instance, the Florida PSC allowed a 85% OSS flow-through rate for Sprint's ILEC operations even though Sprint admitted that it had not upgraded its OSS to more efficient systems available.[36] Likewise, integrated digital loop carrier ("IDLC") is a more efficient, less costly technology, but states still allow for an assumption of a significant use of universal digital loop carrier ("UDLC") facilities.[37] Thus, the Commission's rules have by no means promoted use of "hypothetical networks," nor has the state commissions' application of the rules.

The Court noted the fundamental problem with pricing based on the RBOCs' embedded actual costs:

> As for an embedded-cost methodology, the problem with a method that relies in any part on historical cost, the cost the incumbents say they actually incur in leasing network elements, is that it will pass on to lessees the difference between most-efficient cost and embedded cost. Any such cost difference is an inefficiency, whether caused by poor management resulting in higher operating costs or poor investment strategies that have inflated capital and depreciation. If leased elements were priced according to embedded costs, the incumbents could pass these inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. The upshot would be higher retail prices consumers would have to pay.[38]

The Court noted that even if "incumbents have built and are operating leased elements at economically efficient costs, the temptation would remain to overstate book costs to ratemaking commissions and so perpetuate the intractable problems that led to the price-cap innovation."[39]

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35 *Verizon,* 122 S.Ct. at 1669.

36 *See* Order No. PSC-03-0058-FOF-TP, Final Order On Rates for Unbundled Network Elements Provided by Sprint-Florida Incorporated in Docket No. 990649B-TP at 160-161, *In re: Investigation into Pricing of Unbundled Network Elements (Sprint/Verizon Track).*

37 *See, e.g., In the Matter of Application by BellSouth Corporation, et al., for Authorization to Provide In-region InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, WC Docket No. 02-150, Memorandum Opinion and Order, FCC 02-260, ¶¶ 56-63 (Sept. 18, 2002).

38 *Verizon,* 122 S.Ct. at 1673.

39 *Id.* at 1673.

The reality, however, is that the RBOCs did not build or run their operations at economically efficient costs.[40]

The Court also noted that RBOCs, contrary to having their investments unrecoverable through depreciation, benefited from underdepreciation. The Court stated that:

> As we have described, underdepreciation (to the extent of its continuation today, which the Government disputes, Brief for Respondent Federal Parties 38-39) was undertaken largely by the incumbents themselves, not forced upon them by regulators, as a means to keep the rate base inflated under the public- utility model of regulation. See *supra,* at 1659-1660, 1666. For all we know, the incumbent carriers may yet be seeking low rates of depreciation in state retail-rate proceedings still conducted under that model, even as they seek high depreciation rates here today to factor into the wholesale prices they may charge for the same elements they use to provide retail services. In short, the incumbents have already benefited from underdepreciation in the calculation of retail rates, and there is no reason to allow them further recovery through wholesale rates.[41]

The Court went as far as to note that there even is an argument that the Act explicitly forbids embedded-cost methodologies, and that even though the Commission refrained from this interpretation, "it seems safe to say that the statutory language places a heavy presumption against any method resembling the traditional embedded-cost-of-service model of ratesetting."[42] This is the presumption that Verizon must overcome in promoting its methodology based on its actual costs.

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40 *Id.* at 1676. As the Court noted:

> we have already noted the consequence of the utilities' approach, that the "book" value or embedded costs of capital presented to traditional ratemaking bodies often bore little resemblance to the economic value of the capital. See FCC Releases Audit Reports on RBOCs' Property Records, Report No. CC 99-3, 1999 WL 95044 (FCC, Feb. 25, 1999) ("[B]ook costs may be overstated by approximately $5 billion"); Huber et al. 116 (We now know that "[b]y the early 1980s, the Bell System had accumulated a vast library of accounting books that belonged alongside dime-store novels and other works of fiction .... By 1987, it was widely estimated that the book value of telephone company investments exceeded market value by $25 billion dollars").

Id.

41 *Id.* at 1676, n. 34.

42 *Id.* at 1673.

Verizon is asking the Commission to return to the very type of ratemaking Congress sought to proscribe through the 1996 Act. The Court noted that Congress in proscribing traditional rate-of-return approaches was "firing a warning shot to state commissions to steer clear of entrenched practices perceived to perpetuate incumbent monopolies."[43] Both this Commission, and state commissions, rightfully employed a pricing methodology designed to uproot, not perpetuate, monopolies. Verizon's filing of this Petition is a telling sign of the Commission's success. Verizon asks this Commission to return to pre-1996 ratemaking as if the 1996 Act never occurred. The language of the Act, and the Supreme Court's ruling, stand in the way, however.

D. TELRIC Does Not Lead to Artificially Low UNE Rates

Verizon also contends that TELRIC functions as "black box" because it lacks objective criteria or standards on which to base rates and accordingly provides considerable latitude to set rates without regard to costs. The U.S. Supreme Court explicitly rejected this criticism of TELRIC. The Court in fact noted that TELRIC was preferable to prior ratemaking approaches.[44]

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43 *Id.* at 1674, n. 31.

44 *Verizon Communications, Inc., et al., v. Federal Communications Commission, et al.,* 122 S.Ct. 1646, 1677 (2002). The Court noted:

> "One important potential advantage of the T[E]LRIC approach, however is its relative ease of calculation. Rather than estimate costs reflecting the present [incumbent] network -- a difficult task even if [incumbents] provided reliable data -- it is possible to generate T[E]LRIC estimates based on a 'green field' approach, which assumes construction of a network from scratch." To the extent that the traditional public- utility model generally relied on embedded costs, similar sorts of complexity in reckoning were exacerbated by an asymmetry of information, much to the utilities' benefit. And what we see from the record suggests that TELRIC rate proceedings are surprisingly smooth- running affairs, with incumbents and competitors typically presenting two conflicting economic models supported by expert testimony, and state commissioners customarily assigning rates based on some predictions from one model and others from its counterpart. At bottom, battles of experts are bound to be part of any ratesetting scheme, and the FCC was reasonable to prefer TELRIC over alternative fixed-cost schemes that preserve home-field advantages for the incumbents.

Id.

In fact, the RBOCs, if anything, have benefited from the latitude TELRIC provides because many state commission have set wholesale prices at points halfway between forward-looking costs and forward-looking costs plus the average retail margin.[45]

Despite this, Verizon bemoans the recent reduction in TELRIC rates that has occurred in many states. This is not unexpected as states have conducted subsequent rounds of TELRIC proceedings and have become more experienced in the process. The FCC noted in the Massachusetts 271 proceeding:

> New developments, technologies, and information, including information as to the kind of switch discounts that would be available if a carrier were building an entire network, have become available since that time. As always, we presume that the Massachusetts Department, like other state commissions, will examine these issues during the course of its ongoing rate case and set rates within the range of what a reasonable application of what TELRIC would produce.[46]

It is not surprising that new developments, technologies, and information will lead to lower rates. In fact, this was the central premise of price cap regulation. The notion was that as carriers become more efficient they will have lower costs vis-à-vis the price cap thereby generating higher profits. Also it should not be forgotten that many rates were reduced in the context of Section 271 proceedings where RBOCs reduced their rates to become checklist compliant.[47] Now having the reaped the benefits of the bargain, RBOCs seek to evade the cost.[48] Also one of

45 T.R. Beard, G.S. Ford, C.C. Klein, *Bell Companies As Profitable Wholesale Firms: The Financial Implications of the UNE-Platform: A Review of the Evidence*, CommLaw Conspectus, Journal of Communications Law and Policy at 8 (Fall/Winter 2003)(forthcoming publication) ("*Beard, et al.*").

46 *Massachusetts 271 Order.* at ¶ 35.

47 See, *e.g.*, *Application by Verizon New Jersey Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance, NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in New Jersey*, Memorandum Opinion and Order, WC Docket No. 02-67, FCC 02-189, ¶¶ 61-73 (rel. June 24, 2002).

48 *See*, *Qwest Corporation v. U.S.*, 48 Fed.Cl. 672, 696 (2001). The Court of Federal Claims noted that Plaintiff Qwest's physical takings claim must be considered in the "context of the comprehensive legal framework established by the Telecom Act." *Id.* The court noted that the Telecom Act "created a matrix of interlocking opportunities for ILECs" where "they could enter some new markets, but the *quid pro quo* was that they open up their own local exchange markets to competition." *Id.*

the major factors, if not the major factor in the reduction of UNE-P prices has been the reduction in loop rates. From January 2003 to July 2003, the national unbundled loop rate average declined 2.0% while the UNE-P rate declined 2.8%.[49] Thus, Verizon's attack on declining UNE-P prices is really a thinly veiled attack on UNE loop prices.

Verizon's sole evidence of its claim of "artificially low rates" are a series of financial analyst reports. As a threshold matter, it is important to note that Verizon is asking the Commission to give greater weight to the reports of organizations whose area of expertise is not to conduct cost proceedings over the findings of state commissions who have been setting rates for the RBOCs for years. Surely the state commissions would not allow "artificially low rates" for the RBOCs, and, if in any case they did, would be subject to reversal by a federal district court. Thus, there is simply no reason for the Commission to disturb the reasoned decision making of these state commissions. In fact, despite RBOC claims from the inception of TELRIC that it would preclude their ability to recover their costs, RBOCs have not been able to prove in any court that TELRIC UNE rates are confiscatory. If the rates are truly artificially low surely they should have been able to prove such a claim.

In fact, even if the UNE rates are too low in the zone of reasonableness it is premature to consider if there will be a shortfall for RBOCs. As noted in the *Local Competition* proceeding, "the size of any shortfall between historical costs and TSLRIC's forward-looking costs will not be determined for many years after interLATA entry." *Local Competition Order*, ¶ 655. Petitioner conceded in the *Verizon* case that interstate access and long distance charges are two sources of revenue that may provide recovery for stranded costs. Brief for Petitioners Verizon Communications, Inc., et al., at 36, n. 15, *Verizon Communications, Inc., et al. v. Federal Communications Commission, et al., cert. granted*, 531 U.S. 1124 (Jan. 22, 2001), *opinion issued*, *Verizon Communications, Inc. et al., v. FCC*, 122 S. Ct. 1646 (2002). For instance, access charges for years have been set well in excess of the RBOCs' economic costs of providing access service to provide subsidies for universal service. Alfred Kahn & William Shew, *Current Issues in Telecommunications Regulation: Pricing*, 4 Yale J. Reg. 191, 193-95, 202, n.28 (1987). Likewise, the RBOCs' entry into the interLATA market pursuant to the 1996 Act will provide substantial revenue that should more than compensate for any nominal stranded cost there may be. It should not be forgotten that the RBOCs were among the supporters of the 1996 Act, and it is reasonable to believe that it was their recognition of the lucrative benefits of interLATA entry that fueled this support. *See,* P.L. 104-104, S. Rep. 104-23 at 26-29 (1995).

[49] NRRI, A Survey of Unbundled Network Elements Prices in the United States at 1 (July 1, 2003).

Second, these financial reports are glaringly incomplete. Many of the reports ignore non-recurring charges which are a significant source of revenue to the RBOCs.[50] The reports also significantly understate overall RBOC revenue from wholesale lines.[51] A study by the Phoenix Center for Advanced Legal & Economic Public Policy Studies found that RBOC wholesale operating costs are significantly less than what is reported by financial analysts.[52] The study also found that RBOC wholesale revenues are significantly higher than what is reported by financial analysts.[53] Commenters are not seeking to impugn financial analyst findings, but just seek to note that rate comparisons are very complex and require very detailed comparisons. It is clear that evaluations of similar data have led to strongly divergent conclusions. There is simply no basis to reach any definitive conclusions based on statistics Verizon has submitted. This is also the more reason why the Commission must embark on more detailed fact finding before reaching any conclusions. State commissions should also be provided the opportunity to defend their rates.

Verizon's Petition begs the question of whether TELRIC should be modified. Verizon has not substantiated its claims, and as demonstrated above, at a minimum an equally strong case can be made that Verizon's claims are incorrect. The Commission cannot make any ruling on Verizon's request for forbearance until it evaluates the validity of Verizon's predicate argument that TELRIC is flawed.

E. The Commission May Not Prejudge the Outcome of the Rulemaking

The Commission is poised to embark on such a comprehensive rulemaking to revisit issues surrounding TELRIC. That is the correct vehicle to address the issues Verizon raises.

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50 *Beard, et al.* at 11.
51 *Beard, et al.* at 13. The understatement ranges from 11% to 43%.
52 *Beard, et al.* at 19.

Granting Verizon's Petition, in any part, would prejudge the issues in that proceeding, and on a less than ideal record. The Commission would have to determine that a focus on actual embedded costs, as opposed to economically efficient, forward-looking costs is more suited to promoting competition and promoting investment. The Commission would have to determine that a full application of TELRIC principles is no longer necessary or warranted. The Commission would also have to determine that UNE prices are in fact too low without having benefit of the review of cost data that state commissions have reviewed and evaluated.

Commenters are particularly concerned that Verizon is asking the Commission to make these determinations in the context of one particular industry segment, *i.e.*, the UNE Platform. While Verizon couches its attack on TELRIC as an UNE Platform issue, the fear is that any Commission determination would impact the Commission's determinations on TELRIC in regard to facilities-based carriers. While the relief sought focuses on the UNE-Platform, the rulings necessary to get to that point implicate pricing for all facilities. Moreover, while facilities-based carriers may not rely on the switching of the RBOCs, loops and transport facilities are also components of the Platform, and any Commission ruling would have implications for carriers that lease those facilities. In fact, as demonstrated elsewhere in these Comments, the reduction in UNE loop prices have been a significant, if not the driving, factor in the reduction of UNE-P costs. Thus, Verizon's attack is really an attack on general UNE pricing and in particular UNE loop pricing. Facilities-based carriers that utilize loop, transport and EEL facilities will be affected by these modifications. Verizon is therefore seeking to undermine the rates that promotes facilities-based competition as well. This is all the more reason why these

[53] *Beard, et al.* at 20.

issues should be considered in an omnibus proceeding where a more comprehensive record can be created.

II. TELRIC PRICING PROMOTES FACILITIES-BASED COMPETITION

A. Numerous Studies Show that TELRIC Promotes BOC and CLEC Investment

Verizon also contends that TELRIC discourages investment by all carriers.[54] Once again this contention flies in the face of reality. The period of 1996 to early 2001 witnessed unprecedented investment in the telecommunications industry. While it is true that investment has declined in the last two years this has been more the function of a sluggish economy, closed capital markets, and diminished network needs as opposed to a response to TELRIC prices.

As with many of the other arguments that Verizon has raised, the notion that TELRIC does not spur investment has been unequivocally considered and rejected by the U.S. Supreme Court. The Court noted that "the claim that TELRIC is unreasonable as a matter of law because it stimulates but does not produce facilities-based competition founders on fact."[55] The Court observed that new entrants have invested in facilities to the tune of $55 billion from the passage of the Act to 2000. CLECs reinvest a much larger portion of their revenues back into their facilities than the RBOCs, 63.7% to 20.6% respectively.[56]

The Court also observed that the FCC's statistics indicate substantial resort to pure and partial facilities-based competition among the three entry strategies: as of June 30, 2001, 33 percent of entrants were using their own facilities; 23 percent were reselling services; and 44 percent were leasing network elements (26 percent of entrants leasing loops with switching; 18

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[54] Verizon Petition at 2. It is ironic that Verizon claims to speak for facilities-based competitors when Verizon has never attempted to compete outside its territory. Commenters, who are facilities-based CLECs that access capital markets, decide where to deploy facilities and compete head-to-head with a monopolist, can attest that Verizon's contentions about TELRIC discouraging investment are counter to fact.

[55] *Verizon,* 122 S.Ct. at 1675.

percent without switching).[57] The Court concluded that "it suffices to say that a regulatory scheme that can boast such substantial competitive capital spending over a 4-year period is not easily described as an unreasonable way to promote competitive investment in facilities."[58] To put it mildly, TELRIC has succeeded .

TELRIC also has not stymied RBOC investment. During the same period, the RBOCs invested over $100 billion. The Phoenix Center reported that the *additional* telecommunications investment, *i.e.,* over and above what was expected, from 1996 to 2001 was in the range of $267 billion.[59] From 1980 to 1995, telecommunications investment grew at an annual rate of 2.8%, with an average annual investment level of approximately $39 billion. After the 1996 Act, investment grew at an average annual rate of 22.3% with about $95.3 billion being invested annually.[60] Statistics also demonstrate that the RBOC total plant in service continues to rise, and RBOCs invest more significantly in states where there is competition.[61] AT&T conducted a study which unequivocally demonstrated that the highest areas of ILEC investment were in those markets where it was subject to the most UNE-based competition from CLECs.[62] As the Court noted, this reaffirms the "commonsense conclusion that so long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base."[63]

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56 *Id.*

57 *Id.* at 1675.

58 *Id.* at 1676.

59 Phoenix Center Policy Bulletin No. 5, Competition and Bell Company Investment in Telecommunications Plant at 1 (July 9, 2003) (Phoenix Center Bulletin No. 5).

60 Phoenix Center Bulletin, No. 4, The Truth About Telecommunications Investment at 3 (June 24, 2003) (Phoenix Center Bulletin No. 4).

61 Phoenix Center Bulletin No. 5 at 4.

62 CC Docket No. 01-338, Comments of AT&T Corp. at 68-69 (April 5, 2002).

63 *Verizon,* 122 S.Ct. at 1666.

A classic proof of the theorem that "if there is competition, RBOC investment will follow" is the fact that competitive provisioning of DSL spurred the RBOCs to deploy DSL service. A former Chief Economist for the FCC attributed the spread of DSL to the consumer market as a direct consequence of unbundling noting that:

> [I]n the case of DSL, the technology was not deployed at all to provide retail, high-speed data services when local exchange companies had regional monopolies. Carriers did not offer DSL service as a consumer product on its own until late in 1996. That year, the Telecommunications Act of 1996 ("the Act") opened the local telephone market to competition. The Act required incumbent telephone companies to lease out elements of their systems for competitors to use to provide service. New entrants were then able to lease copper "loops" that link central offices to customers, install their own DSL equipment and connections to the internet, and offer high-speed data service to customers that was cheaper and easier to obtain than T1 service.[64]

ILECs have possessed DSL technology since the 1980s, but did not offer it for fear it would impact other lines of business.[65] Only when CLECs and cable companies started offering broadband were the ILECs spurred to enter the DSL market.[66]

Petitioner, however, ignores the first five years of staggering telecommunications investment, all effected while TELRIC was in place,[67] and instead focuses on the recent downturn in investment. Petitioner contends that this downturn is due to TELRIC, and in particular, the recent decrease in TELRIC rates. Petitioner conveniently ignores other, more likely, causes for the decrease in investment. For instance, reading Verizon's Petition, there is no indication that we have just endured an economic downturn. In fact, no mention is made of

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64 Phoenix Center Bulletin No. 5 at 6, *citing,* H.A. Shelanksi, Competition & Deployment of New Technology in U.S. Telecommunications, U. Chi. Legal. F. 85 (2000).

65 *Id.* at 75.

66 *Id.*

67 While the FCC stayed its pricing rules, the vast majority of state commissions independently utilized the TELRIC methodology. Brief for Petitioners Federal Communications Commission and the United States at 8, *Verizon Communications, Inc., et al. v. Federal Communications Commission, et al., cert. granted*, 531 U.S. 1124 (Jan. 22, 2001), *opinion issued, Verizon Communications, Inc. et al., v. FCC,* 122 S. Ct. 1646 (2002).

the fact that capital expenditures are down for companies across a broad spectrum of industries due to the closing of capital markets. Studies show that investment by telecommunications firms is caused by economic growth, but not vice versa.[68] Capital expenditures are down because there is no capital to invest. In addition, it is also expected that after a spurt of initial investment, investment will decline once initial network construction nears completion.[69] Also the downturn in the industry has led to significantly reduced prices for equipment which means that carriers can get much more equipment for reduced amounts. Carriers with available capital can get attractive deals on equipment.

The Court also rejected the idea that TELRIC should be tweaked to promote investment. The Court noted that the RBOCs argued that some degree of long-run inefficiency ought to be preserved in order to give an entrant an efficient alternative to leasing, *i.e.,* building its own facilities. The Court noted the inherent flaw in this approach was that it perpetuates economic inefficiency and creates barriers to entry.[70]

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68 Phoenix Center Bulletin No. 5 at 8, *citing,* R.O. Beil, G.S. Ford, and J.D. Jackson, *On the Relationship between Telecommunications Investment and Economic Growth in the United States* (June 2003).

69 Phoenix Center Bulletin No. 5 at 7.

70 The Court observed that:

> The first objection turns on the fact that a lease rate that compensates the lessor for some degree of existing inefficiency (at least from the perspective of the long run) is simply a higher rate, and the difference between such a higher rate and the TELRIC rate could be the difference that keeps a potential competitor from entering the market. See n. 27, *infra.* Cf. First Report and Order ¶ 378 ("[I]n some areas, the most efficient means of providing competing service may be through the use of unbundled loops. In such cases, preventing access to unbundled loops would either discourage a potential competitor from entering the market in that area, thereby denying those consumers the benefits of competition, or cause the competitor to construct unnecessarily duplicative facilities, thereby misallocating societal resources"). If the TELRIC rate for bottleneck elements is $100 and for other elements (say switches) is $10, an entering competitor that can provide its own, more efficient switch at what amounts to a $7 rate can enter the market for $107. If the lease rate for the bottleneck elements were higher (say, $110) to reflect some of the inefficiency of bottleneck elements that actually cost the incumbent $150, then the entrant with only $107 will be kept out. Is it better to risk keeping more potential entrants out, or to induce them to compete in less capital-intensive facilities with lessened incentives to build their own bottleneck facilities? It was not obviously unreasonable for the FCC to prefer the latter.

Verizon argues that use of TELRIC will distort the investment decisions of new entrants because "no company will deploy and scale facilities if it can achieve similar economics immediately by renting network elements from the ILECs . . . ."[71] Verizon fails to consider the corollary of their argument. Setting prices at historical, or actual, costs levels, above long-run economic cost, will either (1) encourage inefficient facilities-based entry by rivals with costs below the ILECs' historical costs, but above the ILECs' economically meaningful forward-looking costs or (2) choke off entry altogether. Efficiency dictates that the build-buy decision be made based upon forward-looking, not historical, costs. If an RBOC can build a loop on a forward-looking basis for $15, but the RBOC's historical cost is $30, the CLEC should be presented with a $15 price to buy the loop from the RBOC. If presented with an option to buy the loop from the RBOC for $30, and if the CLEC's cost to build the loop itself is $20, it will either inefficiently build the loop itself, even though the RBOC is the more efficient builder, or not enter the market at all. The folly of Verizon's argument is that it encourages the wasteful construction of duplicative facilities and stifles market entry.

TELRIC encourages efficient entry and precludes the wasteful deployment of facilities as demonstrated by the example above, because the new entrant will make the decision to build based on what is the most efficient and cost-effective option. If the price to lease an UNE equals the price to build one, the CLEC would still have an incentive to build because (a) there would be no transaction costs with the ILEC to provision the UNE (these costs can be substantial and include time and resources devoted by CLEC personnel); and (b) the CLEC could have full control over the facility without an RBOC intermediary.

As Justice Breyer noted:

Id. at 1672.

> [o]ne can understand the basic logic of "unbundling" by imagining that Congress required a sole incumbent railroad providing service between City A and City B to share certain basic facilities, say, bridges, rights-of-way, or tracks, in order to avoid wasteful duplication of those hard-to-duplicate resources while facilitating competition in the *remaining* aspects of A-to-B railroad service. Indeed, one might characterize the Act's basic purpose as seeking to bring about, without inordinate waste, greater local service competition . . . .[72]

Congress did not want to encourage wasteful duplication of facilities by new entrants. Under TELRIC, if the economic cost to the new entrant dictates that the construction of its own facilities is more efficient and cost-effective, it will build the facilities.

The problem with the historical cost approach is that:

> [p]ermitting incumbent LECs to recover embedded costs in the prices they charge competitors for interconnection and unbundled network elements, while the incumbents experience much lower incremental costs, will result in inefficiently high prices that will either cause new entrants to over-build existing systems instead of maximizing the efficient use of the existing incumbent LEC's network, or discourage entry and investment in the local market altogether.

Local Competition Order, ¶ 655. TELRIC has met the Commission's goal of promoting efficient, economic entry.

B. The Decision in the Triennial Review to Limit Unbundling for Broadband Invalidates ILEC Arguments that Pricing Relief Is Necessary to Promote Broadband

This Petition represents the second prong of the RBOC call for "deregulation" to promote investment, particularly in regard to the broadband services. The first prong was seeking unbundling relief in regard to broadband facilities. Having obtained this relief, the RBOCs now want additional pricing relief. This purported "deregulation" also controverts the requirements

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71 Verizon Petition at 6.

72 *Iowa Utilities Board*, 525 U.S. at 416-417 (Breyer, J., concurring in part/dissenting in part).

of the Act. The Court noted that "while it is true . . . that the Act was 'deregulatory' in the intended sense of departing from traditional 'regulatory' ways that coddled monopolies . . . that deregulatory character does not necessarily require the FCC to employ passive pricing rules deferring to incumbents' proposed methods and cost data."[73]

There is no need to provide additional relief to RBOCs to deploy broadband facilities. The fact that competitors will have limited, if no, access to RBOC investment in new facilities really renders moot the need for any pricing relief to promote investment. RBOCs can deploy new facilities knowing that they will not need to lease these facilities at TELRIC rates. Thus, there is no need for any additional "relief."

Essentially ILECs are holding advanced services deployment hostage. They control the vital last mile facilities and are saying that we will not deploy broadband and make new investment unless you protect us from competition.[74] There is no guarantee, however, that if the Commission grants the protection the ILECs seek that new investment will be promoted. Competition is the spur of new investment. Similar to DSL experience, ILECs offered ISDN only sparingly in the 1980s even though the technology was developed in the 1970s.[75] The reason was because there was nothing to prod the ILECs to deploy the new technology. Bruce Mehlman, the assistant Commerce Secretary, Office of Technology Policy, noted in a recent speech that RBOCs have reduced incentives to invest in broadband data since there is less competition from CLECs.[76] As Rep. Markey noted in hearing before the Senate Commerce

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73 *Verizon*, 122 S.Ct. at 1668, n. 20.

74 CC Docket No. 01-338, AT&T Comments at 75.

75 *Id.* at 74.

76 *Bush Still Undecided on Broadband Policy*, Communications Daily, Vol. 22, No. 100 at 1 (May 23, 2002).

Committee, competition also spurs technological innovation.[77] Providing RBOCs' additional relief in the form of relaxed pricing would only disrupt the calculus of competition even more.

In fact, segregating broadband service already threatens to create an anomalous situation. TELRIC prices are based the "most efficient technology currently available."[78] Thus, states will likely set prices based on the most current technology, and CLECs will be paying these prices for UNEs. Under the new unbundling rules, however, CLECs will not get access to this new technology. Instead, they will be restricted to the inferior technology that is the product of the ILEC's "old" investment. Thus, CLECs will be paying for a superior network, but getting access to an inferior one. Verizon would ask that it be allowed to price this inferior network at premium rates.

For instance, hybrid loops are arguably the "most efficient technology currently available for loops." State commissions, therefore, will likely set loop prices based on these loops. The Commission's new UNE rules may, however, limit unbundled access to these loops, and require CLECs to utilize copper loops. Since copper loops are cheaper, and since many copper loops may have been already fully depreciated, the prices of the loops should be modified to reflect the loops CLECs are actually getting. This situation demonstrates that it is important that the Commission when it reconsiders its TELRIC rules also takes into account its new UNE rules and ensure that its pricing rules are in accord with the UNE rules. Verizon's Petition is putting the cart before the horse.

III. ASSUMING THE COMMISSION REASSESSES TELRIC IN ANY RESPECT, IT SHOULD DO SO IN WAYS THAT PROMOTE AND PROTECT FACILITIES-BASED COMPETITION

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77 Communications Daily, Vol. 22, No. 100 at 5 (May 23, 2002).

78 47 C.F.R. § 51.505(b). Note this is further evidence of the Commission's desire to use an evolving notion of technology.

A. Current TELRIC Pricing Rules Are Essential for Bottleneck Facilities – Loops, Transport

The Supreme Court's ruling emphasized the particular importance of TELRIC pricing in regard to essential bottleneck facilities such as loops and transport facilities. The Court noted that:

> a policy promoting lower lease prices for expensive facilities unlikely to be duplicated reduces barriers to entry (particularly for smaller competitors) and puts competitors that can afford these wholesale prices (but not the higher prices the incumbents would like to charge) in a position to build their own versions of less expensive facilities that are sensibly duplicable.[79]

The Court noted that:

> Justice BREYER may be right that "firms that share existing facilities do not compete in respect to the facilities that they share," *post,* at 1693, (at least in the near future), but this is fully consistent with the FCC's point that entrants may need to share some facilities that are very expensive to duplicate (say, loop elements) in order to be able to compete in other, more sensibly duplicable elements (say, digital switches or signal-multiplexing technology). In other words, Justice BREYER makes no accommodation for the practical difficulty the FCC faced, that competition as to "unshared" elements may, in many cases, only be possible if incumbents simultaneously share with entrants some costly-to-duplicate elements jointly necessary to provide a desired telecommunications service.[80]

The Court added that:

> Justice BREYER elsewhere recognizes that the Act "does not require the new entrant and incumbent to compete in respect to" elements, the "duplication of [which] would prove unnecessarily expensive," *post,* at 1691. It is in just this way that the Act allows for an entrant that may have to lease some "unnecessarily expensive" elements in conjunction with building its own elements to provide a telecommunications service to consumers. In this case, low prices for the elements to be leased become crucial in inducing the competitor to enter and build. Cf. First Report and Order ¶ 630 (wholesale prices should send "appropriate signals").[81]

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79 *Verizon*, 122 S.CT. at 1668, n. 20.

80 *Verizon*, 122 S.CT. at 1672, n. 27.

81 *Verizon*, 122 S.CT. at 1672, n. 27.

The Court noted that high lease rates for costly bottleneck elements, "duplication of which is neither likely nor desired," would be the rates most likely to deter market entry.[82] The Court noted how the availability of costly-to-duplicate network elements at TELRIC prices could "avoid the risk of keeping more potential entrants out," while "induc[ing] them to compete in less capital-intensive facilities."[83]

Loop and transport facilities are the quintessential "hard-to-duplicate" facilities. If there is a paradigmatic, hard to duplicate "essential" facility it would have to be the loop. In fact, the Commission has noted that the loop is "an element that is widely agreed to have natural monopoly characteristics."[84] The instances of self provisioning of loops are miniscule particularly in comparison to the staggering amount of loops in the ILECs' ubiquitous network. Only 3% of the nation's lines are served by CLECs on their own last mile facilities.[85]

The ubiquitous RBOC transport network is also hard to duplicate given the high cost of extending CLEC networks to additional central offices.[86] For a CLEC to add a central office to its network would cost over $1 million, and would be substantially more if the central office is located several miles from its existing network, which is often the case.[87] For a CLEC to extend its network to the thousands of RBOC of wire centers would take years. The CLEC would also have to collocate in all those central offices, which imposes a separate very significant cost.

The ILECs possess a tremendous advantage in economies of scale and scope. Since ILECs already have substantial demand, and have in-place facilities, ILECs can serve these

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82 *Verizon*, 122 S.CT. at 1675.

83 Petition of Federal Communications Commission for Rehearing or Rehearing *En Banc* at 9, *United States Telecom Assn. v. FCC*, Nos. 00-1012, *et al.*, and 00-1015, *et al.* (D.C. Cir. July 8, 2002) ("*FCC Petition for Rehearing*").

84 *FCC Petition for Rehearing* at 12.

85 CC Docket No. 01-338, *Sprint Comments* at 21.

86 CC Docket No. 01-338, ALTS Comments at 70.

87 CC Docket No. 01-338, WorldCom Comments at 77.

customers at a much lower cost than a CLEC that would have to self-deploy facilities.[88] In addition, since ILECs already have a substantial amount of fiber facilities in place, they can add capacity simply by adding electronics to the fiber. Thus, their incremental costs are much lower than the CLEC who would have to deploy new fiber and then the electronics to serve additional customers.[89] The costs of deploying new fiber facilities are approximately $200,000-$300,000 per mile in densely populated areas and transport equipment cost may exceed $300 per line. On top of that the CLEC must factor in collocation costs that will range from $15,000 to $500,000.[90] These are all up-front costs incurred before customers are served. This funding may have been achievable in the heyday of the capital markets for telecom, but now the markets are virtually closed.[91]

CLECs will build, and have built, their own loop and transport facilities but only where it makes economic sense to do so. As the FCC has noted, requiring CLECs to self-provision facilities such as loops would "materially raise entry costs, delay broad-based entry, and limit the scope and quality of a competitor's offerings," and is "not an adequate alternative for loops that a carrier can obtain from an incumbent LEC." *UNE Remand Order*, ¶¶ 181-182. The historical cost approach would thus lead to the inefficient overbuilding of facilities that will delay competitive entry.

Use of an historical cost approach may effectively preclude CLEC utilization of ILEC network elements since it would be cost-prohibitive to do so. Thus, CLECs, if they desire to remain in the market, may be forced to overbuild ILEC facilities at a time when available capital is scarce. Under this scenario, available capital will be wasted on an inefficient duplication of

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88 CC Docket No. 01-338, AT&T Comments at 128.
89 CC Docket No. 01-338, AT&T Comments at 130.
90 CC Docket No. 01-338, AT&T Comments at 126.

ILEC facilities when it would be much more efficient and reasonable for the CLECs to lease network elements from the ILEC. The capital wasted could be more prudently invested in needed facilities to extend the reach of telecommunications service, rather than to create duplicative facilities.

Thus, loop and transport facilities are the exact type of facilities for which TELRIC pricing is vital. Raising the costs of these facilities above forward-looking economic costs could force CLECs to either deploy inefficiently these facilities or forego serving particular customers. Given the state of capital markets, the latter option would be the likely option, and competition would suffer.

B. Any Revised TELRIC Pricing Should Focus On Continuing Access to Loops and Transport

The Commission, if it decides to make any modifications to TELRIC, should tailor its TELRIC pricing methodology such that the price for each UNE should vary on the extent to which CLECs have access to competitive alternatives, or the extent to which they can self-provision. This would be in accord with the position articulated by both the majority and minority opinions in *Verizon* that TELRIC pricing is particularly important for hard-to-duplicate facilities. These are the facilities that are the most entrenched in the monopoly legacy of the RBOCs, and the UNEs most in need of "uprooting" via pro-competitive pricing rules.

In particular the Commission should ensure that its TELRIC pricing rules favor loops and transport given the lack of competitive alternatives for these facilities. If anything, the Commission should implement modifications to TELRIC that would further reduce the price of

[91] CC Docket No. 01-338, WorldCom Comments at 21; CC Docket No. 01-338, AT&T Comments at 141.

unbundled loop and transport facilities. This is particularly the case given that the Commission will be limiting access to new RBOC fiber deployment.

There is a strong cost basis for reducing charges for loop and transport facilities. The Court noted that the case for rising depreciation rates is particularly weak for loops. The Court observed:

> The local-loop plant makes up at least 48 percent of the elements incumbents will have to provide, see First Report and Order ¶ 378, n. 818 ("As of ... 1995 ... [l]ocal loop plant comprises approximately $109 billion of total plant in service, which represents ... 48 percent of network plant"), and while the technology of certain other elements like switches has evolved very rapidly in recent years, loop technology generally has gone no further than copper twisted-pair wire and fiber-optic cable in the past couple of decades. See n. 10, *supra* (less than 1 percent of local-exchange telephone lines employ technologies other than copper or fiber). We have been informed of no specter of imminently obsolescent loops requiring a radical revision of currently reasonable depreciation.[92]

In addition, the ability of RBOCs to augment capacity on these facilities through use of electronics ensures that these facilities can serve higher levels of utilization thereby driving down the costs of the facilities.

There is also a strong policy rationale for use of TELRIC pricing rules favoring the leasing of loop and transport facilities. CLECs clearly are not able to duplicate the ubiquitous ILEC network overnight. The ILECs have enjoyed a decades long head start in deploying their networks and this deployment was financed by substantial public funding. As this Commission noted, "the incumbent LECs still enjoy cost advantages and superiority of economies of scale, scope and ubiquity as a result of their historic, government-sanctioned monopolies."[93] As the Commission went on to note:

> These economies are now critical competitive attributes and would belong unquestionably to the incumbent LECs if they had "earned" them by superior

92 *Verizon*, 122 S.Ct. at 1678.
93 *UNE Remand Order* at ¶ 86.

> competitive skills. These advantages of economies, however, were obtained by the incumbents by virtue of their status as government-sanctioned and protected monopolies. We believe that these government-sanctioned advantages remain barriers to the requesting carriers' ability to provide a range of services to a wide array of customers, and that their existence justifies placing a duty on the incumbent carriers to share their network facilities.[94]

ILECs were allowed to deploy their own networks at their own speed and without for competition for many years with a guaranteed rate of return. As a recent study by Economics and Technology, Inc. observed, "the RBOCs and other ILECs enjoy enormous advantages stemming directly from the basic scale economies and 'first mover' advantages deriving from their *incumbency* positions in the local telecommunications market."[95] ETI found that as of December 2001, the total market capitalization of the RBOCs was $345.8 billion representing a market premium over book value of $264.4 billion. ETI noted that this premium can be "traced to the firm's acquisition of valuable business assets at less than their market value or perhaps at no cost at all."[96] After divestiture, the RBOCs were "gifted valuable assets and earnings opportunities, enabling them to generate significant additional profits far in excess of what would be permissible under the traditional 'competitive price' standard of public utility regulation."[97] RBOCs were granted "valuable public resources – electromagnetic spectrum and the use of public rights-of-way – without any payment to the government and with the right to exploit such gifted assets without any price regulation or earnings constraints."

The RBOCs have "been permitted to exploit legacy monopoly relationships with customers and other legacy assets to develop and expand into new nonregulated lines of business, without any obligation to compensate the regulated portion of their operations for the

94 *Id.*

95 Lee L. Selwyn, *Subsidizing the Bell Monopolies: How Government Corporate Welfare Programs are Undermining Telecommunications Competition* at 3 (April 2002) ("ETI Study").

96 *Id.* at 25.

97 *Id.*

fair market value of those assets."[98] The RBOCs have been "largely insulated from any serious competitive losses through a variety of funding mechanisms that have shifted preexisting sources of excess profits into fees and other charges that are imposed upon competitors."[99] These fees not only "make the RBOCs whole with respect to any actual competitive 'losses' they may sustain, but concurrently increase competitors' costs and make their entry and success all the more difficult."[100] Under price cap regulation, RBOCs "continue to earn in excess of 425% on their *interstate* services – a monopoly earnings level that could not be sustained under competitive market conditions."[101] Thus, the benefits, both tangible and intangible, that the ILECs have enjoyed have greatly facilitated the deployment of their networks. CLECs meanwhile have to attempt to deploy alternative facilities in the context of competition for funds not only from the RBOCs, but other CLECs as well, with no assurance of any return on their investment. CLECs clearly need pricing relief in regard to hard-to-duplicate network elements to extend their network reach.

Currently the ILECs enjoy significant economies of scale not enjoyed by CLECs.[102] ILECs possess ubiquitous networks that allow them to reach every customer in their service area and provide them with economies of scale.[103] CLECs will seek to achieve these economies of scale as this will allow them to spread the costs of equipment, construction, and marketing across as many customers as possible.[104] As the Commission has noted "where a firm faces both a fixed cost and a constant or declining variable cost, the average unit cost will fall as output

98 *Id.* at 27.
99 *Id.*
100 *Id.*
101 *Id.* at 5.
102 *UNE Remand Order* at ¶ 84.
103 *UNE Remand Order* at ¶ 98.
104 *UNE Remand Order* at ¶ 98.

increases, and the firm's cost structure is said to exhibit economies of scale."[105] Until CLECs begin to exhibit these economies of scale, however, ILECs will posses a tremendous cost advantage vis-a-vis CLECs. The inability to obtain an unbundled network element from an ILEC at appropriately forward-looking rates will increase a CLEC's costs by either forcing it to purchase a more expensive substitute or to self-provision the element at a higher cost because it lacks the economy of scale of the ILEC. The higher cost will reduce the funds available for the CLEC to extend and upgrade its network, and, thus, preclude its ability to achieve the economies of scale of the ILEC.[106] The Commission needs to ensure that its pricing rules continue to effectuate access to bottleneck facilities. Thus, TELRIC is particular vital in regard to the hard-to-duplicate facilities, access to which will help CLECs achieve the economies of scale and scope that ILEC networks enjoy.

IV. VERIZON'S ATTACK ON CLEC ACCESS CHARGES WOULD THWART COMPETITION

A. CLECs Using UNEs May Validly Collect Access Charges

Verizon argues throughout its Petition that CLECs utilizing UNE-P should not be entitled to collect access charges from other carriers because it is the CLEC's underlying ILEC, not the CLEC that is actually providing the access service.[107] Verizon's argument must fail for several reasons.

First, when a CLEC purchases UNEs, including UNE-P, the CLEC becomes the service provider over those facilities. The CLEC is responsible for customer billing and customer service and, in most cases, the customer is not even aware that it is receiving service over facilities leased from another carrier. In addition, access services terminating to those facilities

105 *UNE Remand Order* at ¶ 76.
106 *UNE Remand Order* at ¶ 84, n. 145.
107 Petition at 4, 14-18.

will be in all likelihood terminating to the CLEC's customer, not the ILEC's customer. In such cases, it is the CLEC, not the ILEC, that has a relationship with that customer.

Second, as providers of competitive exchange access services, CLECs are permitted to collect terminating access charges for exchange access traffic terminated to a CLEC's facilities.[108] Nothing in the Commission's access rules requires that a CLEC actually own the facilities to be permitted to collect access charges. Rather, as in many cases in which a lessee is permitted to collect fees from users of the leased property, a CLEC that is leasing UNEs, including UNE-P, from an ILEC is permitted to collect charges for third-parties use of those facilities.

Third, collecting access charges on purchased UNE facilities enables a CLEC to recoup a portion of the cost of those facilities. As Verizon notes (Petition at 14), exchange access charges were designed as a way to help pay for the underlying infrastructure. In a case where the ILEC is providing access service over its own facilities, the ILEC recovers a portion of the cost of those facilities directly from the terminating access carrier. In a case where the ILEC is providing UNEs, including UNE-P, to a CLEC, the costs of the underlying network are recovered through the ILEC's TELRIC-based UNE rates. There is no reason to permit the ILEC to double recover its costs by also collecting access charges for exchange access traffic terminating to those facilities.[109]

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108 *Access Charge Reform*; *Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 01-146, ¶ 8 (rel. April 27, 2001).

109 *Access Charge Reform*, CC Docket 96-262, First Report and Order, 12 FCC Rcd 15982, ¶ 337 (1997) ("*Access Charge Reform Order*"), *aff'd sub. nom. Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998) ("Allowing incumbent LECs to recover access charges in addition to the reasonable cost of such facilities would constitute double recovery because the ability to provide access services is already included in the cost of the access facilities themselves. Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act.").

On the other hand, it is reasonable to permit the CLEC purchasing the UNEs to recover a portion of its costs – the UNE charges paid to the ILEC to reimburse it for the cost of the facilities. In fact, under such a regime, the access charges still indirectly help pay for the cost of the underlying infrastructure because a portion of the access charge revenues collected by the CLEC are in turn paid to the ILEC as UNE charges. Thus, contrary to Verizon's claim, the only thing that would change if the Commission grants Verizon's Petition would be that Verizon could then recognize a windfall in the form of additional access revenues, while its competitor, the CLEC, would be precluded from recovering a portion of its costs. Only Verizon wins under that scenario, at the expense of competition and the public interest.

Fourth, Verizon has offered no valid basis to alter the existing rules. As noted above, the FCC expressly declined to permit ILECs to collect access charges when they provide UNEs.[110] The Commission concluded that ILECs recover the cost of their networks through cost-based UNE rates and that permitting them to also recover access charges would promote double recovery.[111] Verizon has not offered any valid basis for changing or forbearing from this finding or the rules the followed from that finding.

B. Verizon Is Attempting To Grab Additional Access Revenue

While Verizon claims that CLECs are trying to make huge profits from access charges,[112] the fact is that Verizon is trying to increase the amount it receives for UNEs beyond what has been found to be TELRIC-compliant ***and***, at the same time, recover additional access revenues from the same facilities. In essence, Verizon wants to double dip – recover at least the cost of its

110 *See Access Charge Reform Order*, at ¶ 337.

111 *Id.*

112 Verizon ignores the fact that any "profit" a CLEC may recognize through access charges has already been limited by the Commission's *Benchmark Order* requiring CLECs, over a three-year phase-in, to lower their access charges to the same level as the ILEC in that serving area. *In the Matter of Access Charge Reform*; *Reform of*

facilities through UNE charges and receive windfall access revenues for the same facilities. Verizon's argument is a perfect example of monopolistic thinking. In Verizon's world, it is perfectly reasonable to overcharge your competitors for facilities that you control and then simultaneously forbid the purchasers of those facilities from recovering a portion of their costs through access charges. Indeed, under Verizon's reasoning applied to the local exchange market, a CLEC purchasing UNEs from Verizon should not be permitted to charge for local service provided to its customer because Verizon is the entity actually providing service over those facilities.[113] Clearly, competition would not last long under such a regime. For the same reasons, Verizon's proposal to collect access charges on UNE-P facilities should be rejected in favor of competition and the public interest.

V. INTERIM 'RELIEF' IS UNNECESSARY

As noted above, the RBOCs' financial performance is hardly suffering due to TELRIC pricing. In fact, their performance could be termed "robust" at least in comparison to other industries affected by the economic downturn. SBC reported second-quarter results that included the best quarter ever reported by a Bell company for net adds in DSL service.[114] SBC notes that it "changed the competitive landscape" by introducing "highly attractive rates" and "innovative product bundles" that "have delivered outstanding results in terms of new sales, customer retention and improved stability in our core business." SBC, therefore, seems to have no problem responding to competitive pricing. BellSouth reported increased earnings per share for the second quarter 2003 as compared to second quarter 2002.[115] Its bundled packages "fueled retention and reacquisition of residential and small business customers." It should be

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Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 01-146 (rel. April 27, 2001) ("*Benchmark Order*").

113 Verizon Petition at 14.

114 *SBC Reports Second-Quarter Diluted EPS of $0.42*, SBC Communications Press Release (July 24, 2003).

emphasized that these financial results, which hardly portray afflicted, much less dying companies, are reported during what is purportedly the height of reduced UNE rates. Verizon has established no immediate need for the Commission take action to limit application of TELRIC.

VI. THE PETITION FAILS TO SATISFY THE STATUTORY TEST FOR FORBEARANCE

Verizon relies upon what it alleges are low UNE-P rates and a CLEC's ability to collect access charges on UNE-P facilities as a reason for forbearance claiming that the UNE-P pricing rules meet the standards for forbearance set out in Section 10 of the Act. On the contrary, Verizon has not demonstrated any reasonable basis under Section 10 for the Commission to forbear from its current UNE-P pricing rules.

A. The Current UNE Pricing Rules Are Necessary to Ensure Just and Reasonable Charges, Practices and Classifications

As it does throughout it Petition, Verizon claims that because the current pricing rules do not permit ILECs to recover the cost of their facilities, the rules are not necessary to ensure just and reasonable charges, practices, classifications and regulations. In other words, in Verizon's opinion, the pricing regime is not necessary because it prevents Verizon from overcharging competitors. That is precisely the reason the rules are necessary.

The requirement that a rate regime ensure that rates are not unjust and unreasonable is meant to protect against excessive rates, not those that are just and reasonable and based upon appropriate cost and profit assumptions. A just and reasonable rate regime is not meant to protect monopolists' profits. The rates produced by such a regime therefore are not "below any rational measure of costs," but are within the zone of reasonableness supported by the forward-

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[115] *BellSouth Reports Second Quarter Earnings*, BellSouth Press Release (July 23, 2003).

looking costs of a reasonably efficient incumbent. Indeed, it is because of the competitive protections inherent in the just and reasonable standard of UNE rates that those rates are not monopoly rents that completely foreclose or severely limit competitive market entry.

Similarly, the current pricing rules do ensure nondiscriminatory charges, practices, classifications and regulations. As discussed above, the pricing rules ensure that Verizon does not discriminate against its competitors. Forbearing from those rules would permit Verizon and other ILECs to impose excessive UNE rate on CLECs. At the same time, forbearing from the current access rules, and thus prohibiting CLECs from recovering their UNE costs through access charges, would further discriminate against CLECs and harm competition and the public interest.

The Commission's pricing rules are not intended to protect against CLECs discriminating against one another, as Verizon suggests. Rather, the rules are intended to prevent ILECs, such as Verizon, from discriminating against CLECs. In the absence of such rules, there are no effective protections in place to ensure that the rates ILECs charge for UNEs are just and reasonable and nondiscriminatory. Similarly, Verizon's claim that the current rules discriminate against ILECs can be rejected out of hand. This argument can be boiled down to a claim that any rule that reduces Verizon's profits is inappropriate and should be eliminated. As much as Verizon may wish it were so, the Commission's pricing rules are not intended to protect Verizon's monopoly status and ensure its profits. The rules are meant to adequately compensate Verizon for the forward-looking costs associated with operating its network and to promote competition and consumer options and they do just that. Verizon offers no reason to change the current rules.

Focusing on its inability to leverage even greater profits out its competitors, Verizon ignores the fact that its UNE rates are not determined arbitrarily or in a vacuum. Rather, they are determined based upon the cost data provided by Verizon. If that data produces rates that are below Verizon's costs, Verizon can only blame its own failure to measure its forward-looking costs accurately.[116] Alternatively, Verizon can lower its costs or, as Verizon puts it "make business decisions about how best to recovery its costs over [the] full range of services and customers."[117]

Verizon's claim that there is an alternative to the current pricing rules is also without merit and should be rejected. Not surprisingly, Verizon's alternative to increasing UNE rates, and thus benefiting Verizon, is to remove the ability of CLECs to recover their UNE costs through access charges. In other words, a heads Verizon wins, tails CLECs lose proposal. As discussed above, there is no reason, other than contributing to Verizon's already enormous access charge profits, to preclude CLECs from recovering some of the costs of purchasing UNEs through access charge revenues. Indeed, doing so would be inconsistent with the standards for forbearance as it would be contrary to the public interest and would harm rather than protect consumers.

In a declining financial market in which the availability of capital for network deployment is limited, the ability of a CLEC to develop and offer unique services to consumers over UNE facilities creates innovative, competitive alternatives that would otherwise not be available to consumers. In this way, an innovative CLEC can acquire and/or retain customers

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116 While UNE rate proceeding may ultimately result in rates below those proposed by the ILEC, the rates are nonetheless based upon the ILEC's proffered cost data adjusted to account for errors, inconsistencies or deviations in the ILEC's cost studies. Nonetheless, an ILEC, such as Verizon, has ample opportunity in each case to demonstrate its actual costs and the rates necessary to recover those costs. If the ILEC fails to do so, it cannot then ask the Commission to punish its competitors.

117 Petition at 21.

served through UNEs until market conditions enable the CLEC to renew deployment of its own facilities. Forbearing from the existing pricing rules would eliminate this option for competitors and thus, potentially foreclose the availability of such innovative, competitive services to consumers. Verizon has offered no valid reason to thus harm consumers and the public interest.

B. The Current UNE Pricing Rules Are Necessary to Protect Competition

Verizon is also wrong that the current pricing rules are not necessary to protect consumers. Lower UNE rates produce more competitive options and ultimately lower the cost of telecommunications services to consumers. If the Commission were to forbear from its current UNE pricing rules or prohibit CLECs from collecting access charges on UNE facilities, many competitors would be unable to enter or remain in the market, which would reduce the number of competitive options available to and would ultimately harm consumers.[118] Rather than restricting customer choice, as Verizon erroneously suggests,[119] the existing pricing rules encourage investment and enable CLECs to provide competitive service alternatives to consumers. The Commission has recognized that the availability of UNEs enables competitors to enter a new market immediately, begin signing up customers and generating revenues, which can, in turn offset some of the costs of network deployment, while their networks are being deployed.[120] Similarly, in some cases, utilizing UNEs to serve customers can more efficient than deploying redundant facilities prior to a time when those facilities are needed or are economic. This efficiency, in turn, produces competitive rates for consumers and avoids the costs to the

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[118] *Access Charge Reform Order*, at ¶ 337 ("Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act. If incumbent LECs added access charges to the sale of unbundled elements, the added cost to competitive LECs would impair, if not foreclose, their ability to offer competitive access services.")

[119] Petition at 21.

[120] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238, at ¶ 6 (Nov. 5, 1999) ("*UNE Remand Order*").

market of underutilized, duplicative facilities. Regardless of the variety or quality of a competitor's service offerings, those benefits may not be economically available to consumers if the CLEC has been forced to deploy expensive, redundant facilities prematurely, which is the "investment" Verizon encourages.

In addition, as discussed above, a CLEC relying upon UNEs has the flexibility to provide a broad range of competitive service offerings to consumers. Through these facilities, together with the CLEC's own network, the CLEC can develop an unlimited variety of high-quality, innovative telecommunications service offerings to the public. Foreclosing the flexibility provided by UNEs or making them less economic by prohibiting CLECs from recovering access charges on UNE facilities, rather than promoting customer options, could actually reduce the number of competitors in a market, thereby effectively reducing the competitive options available to consumers in that market.

Moreover, contrary to Verizon's claims, and as noted above, reasonable UNE rates have not discouraged investment in new facilities. Prior to the decline in the financial markets and the resulting reduction in available capital for telecommunications carriers, ILECs and CLECs both invested billions of dollars in new infrastructure. The availability of reasonably priced UNEs contributed to this development by enabling CLECs to enter new markets immediately and begin attracting customers and generating revenues while their networks were being deployed.

Rather than addressing this performance, Verizon chooses to focus on the period since the decline in the capital markets. Throughout its Petition, Verizon cites this period as evidence that UNE pricing, and UNE-P in particular, have caused a reduction in investment.[121] The overall decline of the financial markets, including as Verizon noted the $2 trillion decline in the

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121 Petition at 5-9, 19-21.

capitalization of the telecommunications industry since 2000,[122] is significantly more likely to have contributed to the decline in infrastructure investment and network deployment than is a reduction in UNE rates. Yet Verizon ignores the clear implications of this data.

In fact, in a declining market, in which additional capital is unavailable or difficult to obtain, industry participants, both ILECs and CLECs, turn to reducing costs to protect revenues and cash flow. In such an environment, the lower initial costs of UNEs, which significantly utilize existing facilities and therefore do not require the expenditure of additional capital by the ILEC, become more attractive to competitive providers and new entrants. Thus, using UNEs instead of deploying more capital intensive infrastructure is not only understandable, but makes good business sense.

Moreover, as noted above, Verizon's investment over the last several years has actually increased in those markets in which it is subject to competition. This proves that, contrary to Verizon's claims, the existing pricing rules are actually encouraging investment, and in particular ILEC investment, in new facilities as a result of the competition provided by the current prices.

C. The Existing Pricing Rules Are Necessary to Promote the Public Interest

As discussed above, Verizon's claims that the current pricing rules have contributed to the decline in telecommunications investment is completely unfounded, logically flawed and should be rejected in their entirety. In fact, in a declining market, it is all the more important that the Commission refrain from drastically altering the existing regulatory environment. Investors are already reluctant to invest in the telecommunications industry in general and in competitive carriers in particular. Altering the existing UNE pricing and access charge rules as Verizon suggests will send a negative signal to the investment community and will have a significant

[122] Petition at 5.

chilling effect on investment in competitive carriers. The public interest requires that the Commission reject Verizon's request and retain its existing UNE pricing and access charges rules.

Moreover, as explained in detail above, the existing UNE pricing rules promote investment in new facilities by enabling CLECs to enter new markets immediately and begin serving customer so that they can plan and deploy their networks effectively and efficiently. While redundant facilities may be in the public interest, it is not in the public interest to have multiple carriers deploying facilities in the same locations simply because they have no alternative to serve customers. Consumers are not well served by the existence of multiple competing providers if one or more of those providers ultimately has to leave the market, transfer it facilities or otherwise discontinue service because of forced facilities deployment. In addition, when a competitive carrier first enters a market, there are a number of uncertainties that weigh against the immediate expenditure of capital to construct a duplication of the ILEC's facilities. Among other things, it is uncertain whether the new entrant will be able to attract customers, whether those customers will remain with the new entrant long enough to complete its facilities, let alone recoup the costs of those facilities, or precisely which areas the new entrant can most efficiently serve. In many cases, a new entrant's initial customers are spread across a particular market and are not located in such a manner as to enable the CLEC to construct facilities efficiently to each customer. The availability of purchased UNEs provides the new entrant with a less costly and more efficient alternative to deploying its own facilities immediately in a haphazard manner.

In addition, even after a CLEC determines when and where it will deploy its network, the actual construction of the network takes time and even in the best circumstances cannot completely duplicate the ubiquitous network of the ILEC. As a result, the facilities-based CLEC may still have to rely on some UNEs purchased from the ILEC in order to complete its network or to serve customers that it is otherwise unable to reach. A regulatory regime in which every carrier, including those that are only just entering a particular market, is required to construct facilities to every customer, will produce an over duplication of facilities, with a corresponding waste of resources, with little or no offsetting public interest benefit. One can only imagine how consumers, businesses and communities would feel if every few months a new competitor would come by and dig up their street or lawn in order to deploy facilities. In addition, such a regime will not produce lower costs to consumers because every carrier will have substantial network investment to recover, and thus, will either have to pass those costs on to its consumers or bear the costs themselves and risk financial shortfalls. The former alternative produces inflated costs throughout the market, the latter option creates uncertainty, instability and a lack of consumer confidence; neither alternative promotes the public interest.

Rather, the public interest is best served by a reasonable regulatory regime that not only enables new entrants to obtain access to facilities to serve their customers immediately, and thus establish themselves in the market, but also provides the CLEC the flexibility to determine when and where to deploy its own facilities to duplicate the ILEC's network. In this environment, consumers are provided multiple, competitive options for their telecommunications services and carriers are able to plan and deploy their networks in a cost-effective, forward-looking and efficient manner. The current UNE pricing and access rules provide such an environment. Verizon's forbearance proposal, on the other hand, may increase Verizon's profits, but it will lead to fewer options for consumers and unnecessary and inefficient facility construction. Accordingly, while preserving Verizon's monopoly status and enormous profits does not promote the public interest, retaining the existing pricing rules, and all of the pro-competitive, pro-consumer benefits that arise out of those rules does.

VII. THE PETITION SHOULD BE DISMISSED AS AN UNTIMELY PETITION FOR RECONSIDERATION

This Commission's TELRIC pricing rules have been unequivocally validated after nearly seven years of litigation. Verizon, having failed in its attempts to overturn those rules, and having failed in its attempts to convince state regulators to adopt its inflated measures of its costs, now asks the Commission to forbear from applying these rules to the UNE Platform and to preclude the ability of UNE-P providers to assess access charges. This collateral attack on the Commission's pricing rules, which has implications that stretch beyond the UNE Platform, is nothing more than a Petition for Reconsideration that is nearly seven years too late. Verizon admits that this Commission allowed providers of UNEs to receive access charges.[123] This rule was implemented via the *Local Competition Order* in 1996, and the First Report and Order on Access Charges in 1997.[124] Verizon also does not dispute that the Commission in the *Local Competition Order* made clear that the TELRIC rules would be applied to all UNEs and combinations of UNEs, which would include the UNE Platform. Thus, these collateral challenges to the Commission's Order should have been made in a Petition for Reconsideration years ago, not in a thinly disguised Petition for Forbearance.

It is clear that Verizon's Petition for Forbearance is yet another attempt to reargue positions that, as demonstrated above, were rejected not only by this Commission but the U.S. Supreme Court. The fact that the Commission is prepared to commence a rulemaking to revisit

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123 Verizon Petition at 16.

124 *In the Matter of Access Charge Reform*, First Report and Order, 12 FCC Rcd. 15982, ¶ 337 (1997).

TELRIC suggests all the more that a rulemaking proceeding is the proper vehicle for Verizon's recycled arguments.

VIII. CONCLUSION

For the foregoing reasons, the Commission should deny Verizon's Petition.

Respectfully submitted,

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August 18, 2003

CERTIFICATE OF SERVICE

I, Harisha Bastiampillai, hereby certify that on August 18, 2003, I caused to be served upon the following individuals the Comments of Focal Communications Corporation, McLeodUSA Telecommunications Services, Inc., PacWest Telecomm. Inc., and TDS Metrocom, L.L.C. in WC Docket No. 03-157.

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